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BEFORE THE
SURFACE TRANSPORTATION BOARD

Finance Docket No. 35506

WESTERN COAL TRAFFIC LEAGUE - PETITION FOR DECLARATORY ORDER

REPLY ARGUMENT OF
CONSUMERS UNITED FOR RAIL EQUITY

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Consumers United for Rail Equity ("CURE") hereby submits its Reply Argument to the Opening Evidence and Argument submitted by various parties in response to the Petition for Declaratory Order filed herein by Western Coal Traffic League ("WCTL") and the Board's Decision and Order served September 28, 2011.

Allowing the BNSF to Inflate Its URCS Costs and Asset Base by a Premium That It Did Not Pay Will Harm BNSF Rail Customers That Are Subject to Railroad Market Dominance

CURE supports WCTL's position that the Board should not permit any acquisition premium to be included in either the URCS costs or the investment base of BNSF Railway Company ("BNSF"). If the Board prevents BNSF's URCS costs and investment base from reflecting any portion of the Berkshire Hathaway-paid acquisition premium, BNSF would, for regulatory purposes, be in precisely the same position it was prior to the acquisition. BNSF is the same railroad, with the same costs, and the same management, it was before it was acquired by Berkshire Hathaway. There is, therefore, no reason to treat BNSF, for regulatory purposes, any differently than before Berkshire Hathaway paid an enormous premium to acquire all the stock of BNSF to take the second largest railroad in the country private.

BNSF's Opening Evidence and Argument relies on past STB proceedings in which merger or acquisition premiums paid by one railroad when it merged with or acquired another railroad were allowed to be passed through in the combined railroad's costs and investment base. However, BNSF concedes in its filing that the situation here with respect to the Berkshire Hathaway-paid acquisition premium is different. BNSF contends that the $22 billion premium it says Berkshire Hathaway paid should lead to an increase in BNSF's investment base of $8.1 billion, with the rest being assigned to "goodwill", less approximately $1 billion in liabilities, based on the views of the two accounting firms upon which it relied. BNSF itself admits that, if its URCS costs are adjusted as a result of the Berkshire Hathaway-paid premium, some traffic which is now above the statutory jurisdictional threshold of 180% of BNSF's variable costs would fall below that threshold. BNSF claims that the amount of such traffic is about 2% of BNSF's total traffic. The actual percentage may very well be significantly higher. With the vast majority of BNSF's traffic, including captive traffic, moving under confidential contracts, there is no way to easily determine the actual percentage.

Regardless of the amount of traffic affected, CURE cannot conceive that good public policy allows a railroad with market power over approximately a third of its traffic by weight, according to recent studies commissioned by the Board, to employ unilaterally an accounting maneuver that denies even one captive rail customer its right to petition for rate relief from the Board. As the Board understands, with as much as eight-five percent of railroad freight moving under contract, contract negotiations rather than rate complaints normally determine the price rail customers pay for rail transportation in most instances, even where the rail customer is subject to railroad market dominance. For rail customers subject to market dominance, often the threat of challenging a proffered rate at the Board is their only leverage in a contract negotiation. A unilateral accounting maneuver that raises the jurisdictional threshold of the Board may adversely affect in their contract negotiations a large number of captive rail customers who will no longer have the negotiating leverage of threatening to challenge the reasonableness of the rate at the Board.

<u>Contrary to the Arguments of BNSF, the Board Is Not Compelled by Statute or Precedent to Allow the Write Up In Assets in This Specific Case</u>

BNSF's Opening Argument relied on and attached Chapter 7 of the 1987 Report of the Railroad Accounting Principles Board, but that Report supports WCTL, CURE, and the other parties supporting WCTL's position. For example, at pages 41-42 of Chapter 7, the RAPB acknowledged that asset values should be based on historic costs when the agency uses, as it does, the nominal cost of capital to determine revenue adequacy, so as to avoid a "double count" of inflation.

At page 44 of Chapter 7, the RAPB acknowledged – contrary to the position of BNSF and the Association of American Railroads in this proceeding – that regulatory purposes may justify deviations from GAAP, and that alternative methods proposed by the accounting profession "may or may not be appropriate for regulatory purposes; the issue is left to the ICC."

At page 47 of Chapter 7, the RAPB recognized that, at the time of that Report, the railroads had "excess or redundant assets that should be eliminated from the investment base," and that valuation "less than predecessor cost" for underutilized assets "is appropriate." Clearly, there has been much positive change in the financial health of the major freight railroads, including BNSF, in the last twenty-five years. Surely, BNSF would not assert that thirty years after partial deregulation it still has a substantial amount of excess or redundant assets. Were that the case, it is doubtful that Berkshire Hathaway would have paid such a large premium for all the outstanding stock of BNSF or even purchased BNSF at all. If BNSF makes such an assertion, then surely the Board should audit its assets to ensure that this assertion is correct. Therefore, without verified proof of extensive underutilized or redundant assets, valuations in 2011 or later other than on the basis of predecessor costs are not justified by the RAPB's 1987 Report.

Moreover, there is no recognized regulatory principle that suggests or requires that valuation of assets at more than predecessor cost is required or appropriate, especially where the regulatory agency uses the nominal cost of capital for cost determinations and revenue-adequacy determinations. The Board's policy of allowing adjustments to railroad investment bases and URCS costs based on acquisition premiums was based on the assumption that mergers and acquisitions would produce benefits for rail customers, although those benefits were not routinely verified and, we believe, in at least some cases did not occur.

The Rail Transportation Policy in 49 U.S.C. § 10101 ("RTP") also supports the positions advocated by CURE and the other parties that support WCTL's position. In particular, the RTP calls for "accurate," "fair," and "expeditious" STB decisions that do not impose undue burdens on shippers, railroads or other parties. The RTP also provides that it is the responsibility of the Board, not other entities such as the now-defunct

Railroad Accounting Principles Board ("RAPB") or the General Accountability Office ("GAO"), to "determine" the appropriate methodology for ascertain whether freight railroads are earning adequate revenues to maintain their networks and "attract capital". We believe that these statutory provisions support an independent determination of this issue by the Board and also support the exclusion of the Berkshire Hathaway-paid acquisition premium from BNSF's URCS costs and investment base.

Several entities, including the U.S. Department of Agriculture ("USDA"), made submissions in support of WCTL's Petition. CURE generally agrees with those filings, and therefore will not reply to them. However, CURE particularly commends to the Board's attention USDA's filing, because of the importance of it as the spokesman for many important agriculture-related groups in the United States, and that of WCTL because of the importance of the evidence and argument submitted by WCTL.

WCTL and the Alliance for Rail Competition ("ARC"), through the filing of Verified Statements of expert witnesses, have demonstrated what the numerical impact of the Berkshire Hathaway-paid acquisition premium is likely to be on BNSF's URCS costs and investment base. The evidence filed by the BNSF, WCTL, and ARC shows that the inclusion of the acquisition premium could increase the URCS costs of BNSF on the order of 10% or more. According to BNSF's own numbers, the increase in its URCS costs would be 5.6%.[1] Such an increase would have the effect of raising the Board's statutory 180% R/VC jurisdictional threshold to over 190% R/VC.

[1] BNSF Opening Argument at 20.

Inclusion of the premium in BNSF's investment base would also worsen BNSF's apparent "revenue adequacy" under the Board's methodology,[2] and thereby cause maximum reasonable rates prescribed in accordance with the Board's "Three-Benchmark" rate-reasonableness Guidelines to increase by more than the increase in the BNSF's URCS costs This demonstrates that it is not just one shipper – Western Fuels/Basin Electric, as BNSF claims (BNSF Opening Argument at 23) – "that will be directly affected by application of purchase accounting to BNSF's net assets." Those BNSF customers that challenge their rates successfully under the Board's "Three Benchmark" methodology will receive prescribed reasonable rates that will be higher than they would have been without the inclusion by the BNSF of the acquisition premium in its URCS costs. Those BNSF rail customers, such as Arizona Electric Power Cooperative, Inc., that are prescribed a reasonable rate on the basis of revenue to variable cost under any methodology of the Board will also receive a prescribed reasonable rate that is higher than it would have been without the inclusion of the acquisition premium in the BNSF URCS costs. Again, CURE believes that this result cannot possibly be construed as good public policy.

[2] We put the term "revenue inadequacy" in quotation marks because BNSF is considered "revenue-inadequate" only according to the Board's methodology. Obviously, Berkshire Hathaway's Chairman Warren Buffett does not think it is "revenue-inadequate," based on the glowing language about BNSF's profitability in his Feb. 26, 2011 letter to Berkshire Hathaway shareholders (BNSF's 2010 returns were so impressive that BNSF was able to "replenish" over $22 billion in cash Berkshire paid for BNSF with the deal "increas[ing] Berkshire's 'normal' earning power by nearly 40% pre-tax and by well over 30% after-tax."). CURE believes the Board's revenue-adequacy methodology is not accurate, for the reasons given by the late-Professor Kahn and Professor Hass in their Statement and Report which is Attachment A to CURE's October 28, 2011 Opening Evidence and Argument. BNSF's 2011 increase in investment in its own network (*see infra*) is further proof of BNSF's management's belief that BNSF is, indeed, revenue-adequate.

Notwithstanding the arguments of AAR, the Board clearly has authority to grant the relief requested by the WCTL and deny the relief requested by BNSF, despite past claims by the railroads that the Board is obliged to use replacement costs to determine the value of railroad assets, and to include "write-ups" paid for a railroad or its assets in the investment base used to determine railroad revenue adequacy. Most of the relevant authorities are cited in the opening submissions of CURE, the National Corn Growers Association, and other shipper-related entities. The RTP also states that it is the Board. not any other entity, which is assigned the responsibility to make these determinations.

This is a Case of First Impression

We do not believe this is a case where the STB must depart from established policy to deny BNSF the right to write up its assets as it proposes. Rather, we believe the established policy of the Board with respect to the write-up of assets does not apply to the facts of this matter. Although the Board has in certain past proceedings cited by DOT and the railroads, as well as by CURE and other shipper organizations, allowed write-ups of railroad assets as a result of mergers or acquisitions, the courts have held that the Board is entitled to deference on the methodology it uses for determining whether to permit write-ups, or write-downs, of railroad assets. In each of the Board's cases where mergers or acquisitions resulted in an approved write-up of the assets of the surviving railroad, the acquisition premium was paid by the railroad in question.

Fundamentally, the reason that the Berkshire Hathaway-paid acquisition premium should not be included in BNSF's URCS costs and should not affect the Board's revenue adequacy calculations for BNSF is simply this: BNSF did not pay the premium. In other words, BNSF should not be permitted to include in its URCS costs an amount that it did not pay. There is no logical reason why the Board should treat BNSF in the real world as less revenue-adequate or, according to the Board, more "revenue-inadequate" based on a premium paid by a different entity - Berkshire Hathaway - to acquire BNSF. The premium does not represent either costs incurred or investments made by BNSF.

Moreover, there simply were no efficiencies or other benefits to shippers from the Berkshire Hathaway acquisition of BNSF. The transaction is, therefore, fundamentally unlike those in which two railroads merged with each other (as in the *UP-C&NW*, *ATSF-BN*, *UP-SP*, *CN-IC*, and *CN-EJ&E* mergers), or one railroad acquired a portion of another railroad (as in the *Conrail* acquisition, where CSX and NS divided Conrail between them). In those proceedings, the Board essentially determined that the merger or acquisition would provide benefits to shippers, even if shippers might not agree with that conclusion. Here, the acquisition of a railroad by a financial holding company does not provide any benefits whatsoever to the railroad itself, beyond eliminating the need for a Board of Directors and the requirement to report earnings. Indeed, Warren Buffett, Berkshire Hathaway's Chairman, acknowledged that no one at Berkshire Hathaway knew anything about running a railroad, so Berkshire Hathaway has made no changes in BNSF management, but rather has simply allowed BNSF to operate just as it had prior to the acquisition.[3]

While the facts in this case are different from those in prior cases where a write-up was allowed, is the public interest served by allowing or denying the write up of assets

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[3] See Joint Opening Argument of WCTL, *et al.* at 26-27, citing BNSF Video News, Interview with Warren Buffett, Interviewer: Matt Rose (Dec. 3, 2009)(SEC Form 423, filed Dec. 21, 2009)("We've got 20 people in Omaha, and there isn't one of them that knows how to run a railroad.")

that BNSF proposes herein. We assert that the public interest in this case clearly requires that the proposed write up of assets be denied by the Board.

Allowing the Write-Up Proposed by the BNSF Will Not Increase The Railroad's Access to Capital

The comments of the U.S. Department of Transportation in this proceeding state, on page 2, that the Department "is charged with the duty to establish 'transportation policies and programs that contribute to providing fast, safe, efficient, and convenient transportation,' and 'to provide general leadership in identifying and solving transportation problems.'" The Department's comments then state that, in carrying out these responsibilities, the Department seeks to ensure that railroad policy serves the following goals: safety, efficiency, economic growth, livability and continued railroad investment. After discussing each of these goals, toward the end of its comments, the Department also acknowledges the interest of shippers and the public. The Department indicates an interest in learning more from stakeholders through this proceeding and "may offer additional views at a later stage in the proceeding."

Underlying each of the goals for freight railroads articulated by the Department is the need for the railroads to generate enough revenue to attract the capital that will allow them to meet safety standards, maintain their current systems and expand their systems for the nation's anticipated growth in freight. The goal of rail customers is that the BNSF remain a viable, safe transportation system that provides reliable transportation at reasonable rates. The question then is how the proposed write-up of BNSF assets would affect the goals of national transportation policy for the freight railroads and for rail customers?

The write-up of assets as proposed by BNSF will have no affect on the already enhanced ability of BNSF to attract and retain the capital required for its system. BNSF no longer exists as a separately traded entity. BNSF will obtain its capital from and through Berkshire Hathaway. The Chairman of Berkshire Hathaway has stated publicly on several occasions that BNSF will have no problem with capital in the future.[4] Obviously, inside the family of Berkshire Hathaway-owned companies, BNSF must compete for capital. BNSF should have no problem here. In his February 2011 letter to shareholders, the Chairman of Berkshire Hathaway reported that BNSF in 2010 was more profitable than expected, providing approximately 30% of the overall profit of Berkshire Hathaway in 2010. When BNSF seeks capital from outside Berkshire Hathaway, it will no longer just be as BNSF, but as BNSF, a wholly owned and privately held unit of Berkshire Hathaway.

Moreover, allowing or disallowing the inflation of assets for BNSF for use in the annual "revenue adequacy" determination also will not affect BNSF's access to capital inside Berkshire Hathaway. At the time Berkshire Hathaway purchased BNSF at a price that included a $22 billion premium, BNSF was "revenue inadequate" under the determination made by the Board. This determination is supposed to mean that BNSF cannot attract and retain the capital needed to remain an economically viable rail system. BNSF not only attracted the capital of Berkshire Hathaway, but also it attracted a $22 billionpremium over the value of BNSF at the time of purchase. Under the methodology

[4] *See, e.g.*, February 26, 2011 Letter to Berkshire Hathway shareholders: "Burlington Northern's CEO Plans for Accelerated Capex," The Rational Walk, May 12, 2010..

of the Board. BNSF was "revenue inadequate" in 2010, yet the Chairman of Berkshire Hathaway reported that the profits of BNSF were greater than anticipated and provided 30% of the profits of Berkshire Hathaway for 2010. Allowing the proposed inflation of BNSF's assets by $8.1 billion should result in a determination that BNSF is even farther from "revenue adequacy." Such a determination is not likely to have any greater affect on the capital allocation decisions of Berkshire Hathaway than the Board's annual revenue adequacy determinations have had in the past.

Thus, neither allowing nor disallowing the asset base of a non-publicly traded entity, BNSF, in this instance, to be inflated by $8.1 billion will have any effect on the ability of BNSF to attract and retain the capital it will need to maintain and expand its system while achieving the goals articulated by the U.S. Department of Transportation for freight railroads. Allowing the BNSF Write-Up Will Have No Adverse Effect on BNSF Rail Customers with Access to Effective Transportation AlternativesLikewise, the write-up of assets proposed by the BNSF will have no adverse affect on those BNSF rail customers with effective alternative choices for their transportation needs. Recent studies prepared for the Board indicate that about two-thirds of the annual railroad freight, by weight, is subject to transportation competition, while approximately one-third of the annual railroad freight, by weight, has no transportation competition and is subject to railroad market dominance. For the two-thirds traffic by weight that can be referred to as "competitive" traffic, allowing or denying the proposed write-up has no consequence. These rail customers will pay BNSF exactly what the transportation market requires, regardless of what the railroads' URCS costing information might be.

Allowing the Proposed BNSF Write-up of Assets Will Have an Adverse Effect on Those BNSF Customers That Are Subject to Railroad Market Dominance

However, for that approximately one-third, by weight, of BNSF's annual traffic, whether or not the Board allows this proposed $8.1 billion write-up of BNSF assets has enormous consequences. These BNSF rail customers have no transportation alternatives except to use the BNSF and are subject to "take it or leave it" price quotes from the BNSF. No action from this proceeding will constrain the prices that the BNSF may charge their "captive rail customers." But the decision of the Board will determine whether certain BNSF captive rail customers will have access to the Board to challenge BNSF rates that they believe to be unreasonably high.

If the Board allows this $8.1 billion inflation of BNSF assets, some of those assets will be allocated, by BNSF, to the "variable" costs of the railroad. Increasing the variable costs of rates BNSF charges "captive rail customers" will increase the level of rates on BNSF that are equal to the Board's jurisdictional threshold of 180% revenue to variable cost. BNSF then would have the ability to increase rates to its captive rail customers to just below the level of a rate that will equal the jurisdictional threshold, thus denying such captive rail customers their right to challenge their "captive" rate at the Board. For those BNSF captive rail customers that will seek and gain rate relief under the "Three Benchmark" methodology, they will encounter a larger factor added to the methodology for BNSF's increased distance from "revenue adequacy", resulting in prescribed "reasonable rates" that are higher than they would be if the $8 1 billion increase in BNSF asset values were disallowed.

Conclusion

CURE believes that the facts in this matter are sufficiently different from all previous instances where a write-up of assets has been challenged before but allowed by the Board so that this case is not controlled by previous decisions, but rather is a case of first impression. Either allowing or denying the proposed write-up of assets will have no effect on the ability of the BNSF to attract the capital needed to maintain its rail system as a safe, economically viable system and the capital needed to expand itssystem. Likewise, allowing or denying the write-up of assets will have no effect on the ability of BNSF to charge "competitive" rail customers rates the railroad believes to be needed for continued economic viability and growth: the market will determine the price competitive rail customers of BNSF will pay for their transportation services. The modification or non-modification of ERCS cost data also will not constrain the price BNSF may try to charge captive rail customers for their transportation services. However, allowing the write-up of assets proposed by the BNSF could deny certain captive rail customers the right to challenge or threaten to challenge captive rates charged by the railroad and could increase the prescribed rates of BNSF rail customers that challenge proposed rates successfully under the "Three Benchmark" methodology.

Thus, allowing the write-up of assets will not benefit BNSF in its quest for capital but could deny certain BNSF captive rail customers their statutory right to challenge the reasonableness of BNSF rates. CURE strongly asserts that allowing the write-up of assets in this case of first impression would not be good public policy and could harm the continued economic viability of certain captive rail customers on the BNSF system. For the foregoing reasons, and those stated by WCTL in its Petition filed herein, and by the

USDA, CURE, and the other shipper entities and associations in their Opening Evidence and Arguments, as well as the portions of BNSF's Opening Evidence and Argument cited herein, the Board should (1) grant the relief sought by WCTL, and (2) deny the relief sought by BNSF. Specifically, the Board should ensure that the assets of BNSF are not written up to account for the premium paid for BNSF by Berkshire Hathaway, for both URCS costing purposes and for purposes of determining BNSF's investment base used in determining BNSF's revenue adequacy.

Respectfully submitted,

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November 28, 2011

Certificate of Service

I hereby certify that I have served, this 28th day of November, 2011, a copy of the foregoing Comments of Consumers United for Rail Equity on each person shown on the Board's official service list in this proceeding.

Robert G. Szabo

/Robert G. Szabo